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SUPREME COURT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. ~~1353~~ 126

JEROME S. MURRAY AND GRACE H. MURRAY, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States appear at R. 6-71.[1] The opinion of the Tax Court is not officially reported

[1] "R" references are to the Appendix to the petitioners' brief in the Court of Appeals (Vol. I of Transcript of Record).

but unofficially appears at 24 T.C.M. 762. The opinion of the Court of Appeals (Appendix A, *infra*, page 1a) is reported at 370 F.2d 568.

JURISDICTION

The judgment of the Court of Appeals was entered on January 6, 1967 (Appendix B, *infra*, page 3a). The petition for rehearing (Appendix C, *infra*, page 4a) filed by petitioner was denied February 7, 1967 (R, Vol. III, page 23). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the sales of unimproved property and interests therein qualify as capital gain transactions under the principles enunciated in *Malat* v. *Riddell*, 383 U.S. 569.

2. Whether the character of a transaction, as determined for the year of sale, controls as to subsequent collections under the installment method of reporting.

3. Whether the findings of fact support the conclusion that the taxpayer "was also engaged in the business of dealing in real estate and/or contractual interests therein during the years involved in these proceedings" (T.C. Op., R. 48).[2]

4. Whether the Tax Court was correct in holding that its conclusion, set forth in question 3, *supra*, "is buttressed by a consideration of the activities in this field of Stewart's Corner, a corporation wholly owned and controlled by Murray" (R. 50-51).

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[2] Immediately preceding this quotation, in the same sentence, it is stated "In the instant cases we accept petitioner's contention that he was an investor in real estate but we conclude, contrary to petitioner's contentions, that he * * *" (R. 48).

STATUTES INVOLVED

The pertinent provisions of Sections 1221 and 1234 of the Internal Revenue Code of 1954 are set out in Appendix D, *infra*, page 8a.

STATEMENT

The petitioners are husband and wife residing in Annapolis, Maryland. They filed joint Federal income tax returns for the years herein involved with the District Director of Internal Revenue, Baltimore, Maryland (R. 8).

The assets sold were the Gordon Contract (R. 23-27, 51-54); the Berry Option (R. 36-38, 55-56); and the "Adams" or "Potomac" Property (R. 46, 70).

In the Tax Court each of the years 1957-1961 was involved by reason of deficiencies asserted by the Commissioner (R. 6). Under the Tax Court decision the only deficiencies found to be due were for the years 1959 and 1961 (R. 82), and accordingly the appeal to the Circuit Court involved only those years. On appeal the issues were confined to the character, for tax purposes, of collections received in those years by reason of sales made in earlier years. The sale of the Gordon Contract occurred in 1955, and the taxpayer had held that contract for a period of two years and four months (R. 13). The Berry Option was sold in 1956 and had been held by the taxpayer for nine months (R. 15). Both of these sales were reported, and accepted by the Commissioner in the year of sale, as sales of capital assets. The Adams or Potomac Property had been held three years and four months and was sold in 1958 (R. 13). The Gordon Contract was sold as the result of an unsolicited offer to purchase (R. 25-26), and the

taxpayer was passive as to the sale of the Berry Option (R. 37, 97, 102).

Other properties were in dispute before the Tax Court. The taxpayer's position that some of those sales involved properties held for investment was sustained, primarily on the ground that they had produced rental income.[3] The three properties here involved were denied capital gain treatment by the Tax Court, primarily on the ground that they produced no rental or other income, or that no improvements, looking to the production of rental income, had been made.[4]

[3] Georgetown Univ. property (R. 41-42, 62); 1620 Wilson Blvd. (R. 45, 71); 301 Broad St. (R. 46, 71). In connection with the Holmes Bakery property, the taxpayer was credited with making bona fide efforts to lease it, though unsuccessfully (R. 56-57).

[4] Gordon Contract (R. 53); Berry Option, following holding re Gordon Contract (R. 55). The importance which the Tax Court attached to rental income (or lack of it) in determining the character of the sale is manifest from the following excerpt from the opinion (R. 69-70):

> • • • On the precise question involving the proper characterization of particular pieces of real estate (or contractual interests therein) as investments or properties held primarily for sale, we have already indicated our view that important factors are the receipt by the taxpayer during the time he holds the property of substantial rentals from the property or the receipt of rentals over a long period of years or the taking of steps which clearly indicate the intention of the taxpayer to use the property for the production of rental income, such as, for example, the making of substantial improvements thereon. The presence of these factors would indicate that the property was acquired and held as an investment. With regard to the three properties here involved, none of these factors is present.

Notwithstanding the specific findings of the Tax Court leading to the opposite conclusion,[5] the Tax Court, though accepting the petitioner's contention that he was an investor in real estate (R. 48), held that the taxpayer was also in the real estate business, and that the three assets involved herein were sold by him in the capacity of a real estate dealer.

In the Court of Appeals the petitioners urged, *inter alia,* that the Tax Court's findings of evidentiary facts failed to support the conclusion that the taxpayer was a real estate dealer during the years involved; that the items in controversy were determined to have been held primarily for sale to customers in the ordinary course of his business, notwithstanding the principles annunciated in *Malat* v. *Riddell, supra;* that the character of the sale, as determined for the year in which it occurred, fixed the character for all subsequent collections incident thereto; that the Commissioner's action in treating collections in later years in a manner inconsistent with the character of the transaction in the year of sale was arbitrary and capricious, the effect of which was to put the burden of proof on the Commissioner; and that the Tax Court had further erred in holding

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[5] * * * Prior to 1940 a part of petitioner's activity in the real estate business was that of a real estate broker. While he ceased to act as a real estate broker in the purchase and sale of real estate he retained his real estate broker's license until 1955 since he was advised that such a license was necessary in order to enable him to collect rents. During the years here in issue Murray was not listed in the telephone directory as a real estate broker, and he belonged to no association in any way connected with the real estate business. He did no subdividing. Other than in 1956 when a bank to which he was indebted required him to reduce his indebtedness, he had no "for sale" signs on any of his properties, and he did not advertise them for sale. (R. 9)

that the principal factor in determining whether an asset was held primarily for sale to customers in the ordinary course of business was the absence of rental or other income from the property.

The Court of Appeals rendered a brief *per curiam* opinion (Appendix A), affirming the Tax Court, on January 6, 1967, thereby giving blanket approval to the Tax Court's findings and opinion. The petitioners filed a petition for rehearing on January 26, 1967 (Appendix C) requesting reconsideration. The petition for rehearing was denied February 7, 1967, without opinion.

REASONS FOR GRANTING THE WRIT

1. Despite prior holdings involving capital gain transactions,[6] there remained doubt in the lower courts as to the proper interpretation of Section 1221(1) of the 1954 Code, in consequence of which this Court reviewed the problem in *Malat* v. *Riddell,* 383 U.S. 569. That opinion should have laid at rest any existing uncertainty as to the principles to be applied in determining whether a sale of property qualified for capital gain treatment. It is apparent that it did not, which accounts for the second reason for granting the writ.

2. The affirmance, *per curiam,* by the Fourth Circuit herein is in sharp conflict with a recent decision of the Seventh Circuit, *William A. Scheuber* v. *Commissioner,* decided February 2, 1967, 371 F.2d 996, reversing the Tax Court. There, as here, the evidentiary findings were in favor of the taxpayers, but the ultimate finding was against them. There, too, as here,

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[6] *Corn Products Co.* v. *Commissioner,* 350 U.S. 46, 52; 100 L.ed. 29, 35 (1955); *Commissioner* v. *Gillette Motor Co.,* 364 U.S. 130, 134, 4 L. ed. 2d 1617, 1621 (1960).

the gain from the sale was greatly in excess of cost. The Circuit Court, in *Scheuber,* reasoned that the profits "were unrealistically high for items held for resale in day to day operations of a business." In the instant case in the Gordon Contract, for example, the Tax Court found that taxpayer's gain on the entire transaction was $1,890,311.98 (R. 27). This sizeable gain must have been one of "the factors pertinent to this question which we have heretofore mentioned and discussed" (R. 54), in concluding that the Gordon Contract was held primarily for sale to customers in the ordinary course of taxpayer's business.

In *Scheuber* the Seventh Circuit noted that the Tax Court erroneously deprecated the guidelines favorable to the taxpayers in determining the character of the sale, citing as an example the Tax Court's conclusion that advertising and affirmative efforts to sell were unnecessary since a seller's market existed and because Mr. Scheuber was in the business of selling real estate. The Tax Court in the instant case manifestly held a similar view, but the Fourth Circuit approved it. Furthermore, the Seventh Circuit discerned a misapplication of the *Malat* principles in the emphasis laid on the facts that the taxpayer was in the real estate business, and that the properties involved had not been isolated from those held for sale.[7] Similar evidence of misapplication of the *Malat* principles is apparent in the case at bar (R. 13, 15), but the Fourth Circuit failed to take cognizance thereof.

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[7] Its opinion points out that the Malats were also dealers in real estate and operated on a much larger scale than the Scheubers. Here, as found by the Tax Court (R. 13), Murray's individual sales as shown by the returns for years pertinent to issues here involved aggregated 5 for 1955, 6 for 1956, 3 for 1957, 1 for 1958, 1 for 1959, and 3 for 1960 (2 being involuntary conversions; R. 42-43).

Obviously, the views of the Tax Court and the Fourth Circuit, in the case at bar, are poles apart from those of the Seventh Circuit in *Scheuber* as to the application of the *Malat* principles. The number of cases in litigation involving the character of sales of real property (significantly, largely confined to that category) indicates that the problem remains an important question of Federal law, which calls for further enlightenment by this Court.

3. Ever since this Court decided *Arrowsmith* v. *Commissioner*, 344 U.S. 6 (1952), it has been well established that in a transaction involving the sale or exchange of property, the character of the transaction is fixed at the time it occurs; and any subsequent transactions relating to the original sale or exchange partake of the same character.[8] Thus, for example, when the sale of the Gordon Contract in 1955 was reported, under the installment method, as a long-term capital gain transaction and was so accepted by the Commissioner,[9] any collections by the taxpayer pursuant to his installment method of reporting, must necessarily be of the same character.

In the Tax Court the petitioners urged that the approval by the Commissioner of the reporting of the sale in 1955 of the Gordon Contract, and the subsequent

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[8] *Campagna* v. *United States*, 2 Cir., 290 F.2d 682 (1961); *Wener* v. *Commissioner*, 9 Cir., 242 F.2d 938 (1957); *Commissioner* v. *Adam, Meldrum & Anderson Co.*, 2 Cir., 215 F.2d 163 (1954); *Duveen Bros., Inc.* v. *Commissioner*, 2 Cir., 197 F.2d 118 (1952); Mertens, *Law of Federal Income Taxation*, 1966 Revision, § 22.24, n. 6, 7 and § 22.97, n. 59.

[9] R. 22-23, 27, 51. In fact the Commissioner recomputed the capital gain tax for 1955, and made a refund on that account (R. 78).

refund resulting from the Commissioner's recomputation of the amount of capital gain, had the same degree of finality as is accorded a determination of a deficiency from which no appeal is taken. On that premise it was further urged that in later years where collections were received by the petitioners under the installment method of reporting income from said sale, the action of the Commissioner in treating such collections as ordinary income was inconsistent with his treatment of the sale of the Gordon Contract as a capital gain transaction in 1955, since in the intervening years there had been no change in the law and no change in the facts concerning said contract. In response, the Tax Court held, "This argument is without merit" (R. 51). The opinion further states (R. 52):

> * * * As we have indicated above, the respondent made no "determination" with regard to petitioner's return for 1955 which would preclude us from considering on its merits the question of whether respondent erred in his determination in the instant cases that petitioner's net receipts from the Gordon Tract transaction constituted ordinary income rather than long-term capital gains, or would in any way affect the validity of the determinations of deficiency here involved.

In the Court of Appeals *Arrowsmith* v. *Commissioner, supra,* was relied upon in urging that the character of the sale was fixed in the year of sale, which character carried through to all subsequent transactions in connection therewith. As an alternate argument, the petitioners urged upon the Fourth Circuit, as they had in the Tax Court, that in any event it was an arbitrary action for the Commissioner to take an inconsistent position in the later years here involved, and that the effect thereof would be to place on the Com-

missioner the burden of proving that he was in error in treating the transaction in the year of sale as a capital gain transaction.[10] No claim of prior error was made by the Commissioner. It is implicit in the opinion of the Tax Court that it believed the burden of proof to be on petitioner throughout (R. 52-53).

The Commissioner's action, approved by the Tax Court and the Fourth Circuit, would permit the Commissioner, arbitrarily, to determine each year, as to each collection, whether it was ordinary income or capital gain. This is in direct conflict with the *Arrowsmith* principle, which, heretofore, has never been seriously questioned. The conflict was fully argued in the Court below but was not even mentioned in its *per curiam* opinion. The petition for rehearing (Appendix C) was based, in part, upon the failure of the Fourth Circuit either to discuss or to distinguish *Arrowsmith*.

4. The well established principle that an ultimate finding of fact should be supported by evidentiary findings[11] has not been followed in the case at bar. The specific findings of the Tax Court quoted in footnote

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[10] *Helvering* v. *Taylor*, 293 U.S. 507, 511-512 (1935); *Cohen* v. *Commissioner*, 9 Cir., 266 F.2d 5, 11 (1959); *Welch* v. *Commissioner*, 4 Cir., 297 F.2d 309, 311 (1961); *Herbert Kaufman* v. *Commissioner*, 4 Cir., 372 F.2d 789 (1966). *Cf. Seven Canal Place Corporation* v. *Commissioner*, 2 Cir., 332 F.2d 899, 901 (1964); *Robert Louis Stevenson Apartments, Inc.* v. *Commissioner*, 8 Cir., 337 F.2d 681, 687-688 (1964); *Fulton Container Co.* v. *United States*, 9 Cir., 355 F.2d 319, 324-325 (1966); *Commissioner* v. *Riss, et al.*, 8 Cir., — F.2d — (1967), 67-1 USTC ¶ 9292.

[11] *Kelly* v. *Everglades Drainage District*, 319 U.S. 415, 421-422, 87 L.ed. 1485 (1943); *William A. Scheuber* v. *Commissoner*, 7 Cir., 371 F.2d 996 (1967). *Cf. Municipal Bond Corporation* v. *Commissioner*, 8 Cir., 341 F.2d 683, 686 (1965).

5, *supra*, page 5, negate any conclusion that the taxpayer was a real estate dealer during any of the years pertinent to this case. Furthermore, the opinion of the Tax Court concedes that "In the instant cases we accept petitioner's contention that he was an investor in real estate * * *" but concludes that he also was "engaged in the business of dealing in real estate and/or contractual interests therein during the years involved in these proceedings" (R. 48). But where are the facts to support the conclusion that he was also engaged in the business of dealing in real estate or interests therein? It is submitted that instead of facts sufficient to sustain this conclusion, the Tax Court relied upon its preliminary conclusions that—

> (a) Rental or other income was an important factor in determining that a particular property was held for investment; and that the absence of rental or other income strongly indicated that it was held primarily for sale to customers in the ordinary course of his trade or business (R. 69-70).
>
> (b) The amount of profit ultimately to be realized from the sale was a strong indication that such property was being held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business (R. 13, 15, 27).

Both of these preliminary conclusions completely lack support from *Malat* v. *Riddell, supra,* and accordingly would be an unwarranted extension of the *Malat* principles. There, the presence or absence of rental or other income was not considered as a factor, much less an important one, in determining whether the property was held for "the realization of appreciation in value accrued over a substantial period of time."

383 U.S. at 572. And as to the large amount of profit resulting from the sale (R. 27), it merely evidences the realization of appreciation in value under the *Malat* principle, not the contrary conclusion that it is proof of the fact that the property was being held primarily for sale in the everyday operations of taxpayer's business. In *Scheuber, supra,* the Seventh Circuit noted the fallacy of the Commissioner's argument as to the implication which arises from substantial gains by pointing out that such gains would have been "unrealistically high for items held for resale in day to day operations of a business" (371 F.2d at 999). The Seventh Circuit's view is entirely consistent with *Malat.* In the instant case, the Tax Court and the Fourth Circuit held the opposing view.

When, in addition to the foregoing, there are considered the facts found by the Tax Court as to the number of sales, the period of holding of each, and the gain to the petitioner during the several years which are pertinent to this case (R. 13), as well as those sales made by two joint ventures of which petitioner was a member (R. 15), it would be difficult to conclude that the petitioner was in the everyday business of making sales to customers. And when we eliminate from that list the properties referred to in footnote 3, *supra,* also the three properties involving involuntary conversions, from which the petitioner realized long-term capital gains as found by the Tax Court (R. 42-45), such legal conclusion becomes even more tenuous, particularly in light of the absence of normal real estate activities (R. 9). It is apparent that the record does not contain facts sufficient to justify the conclusion that the petitioner was in the real estate business, or that he was holding primarily for sale the three properties herein involved.

5. At the trial of this proceeding the Tax Court admitted in evidence certain tax returns and records relating to a corporation which was wholly owned by petitioner (R. 5, 50-51, 126-127, 130, 158), but which has been recognized by the Government as a separate taxable entity (R. 126). This action was approved by the Fourth Circuit. The holding on this point is in direct conflict with *Municipal Bond Corporation* v. *Commissioner,* 8 Cir., 341 F.2d 683 (1965). That case involved a comparable situation in which the Circuit Court held in part (p. 691):

> * * * under the record here it appears that taxpayer is a separate and distinct corporate entity and no basis has been shown for piercing the corporate veil. Hence, it is our view that *the operations of the other corporations would have no probative force* in establishing taxpayer's purpose of holding real estate except to the extent that it might be shown that the other corporations were acting as an agent for the taxpayer. (Italics supplied; citations omitted.)[12]

Since the corporation involved in the instant case had sustained operating losses during most of the years involved, and since the Commissioner did not offset those losses against the taxpayer's income (R. 126), it is difficult to justify the Tax Court's attempt to "buttress" its conclusion (R. 50-51) by reference to the activities of this corporation (R. 10-12).

The Tax Court itself has held to the contrary in *Ralph E. Gordy,* 36 T.C. 852, 859 (1961), in *Scott Fink,* 23 T.C.M. 475, 480 (1964), and in *Robert Binda,* 22 T.C.M. 1195, 1203 (1963). The Court of Claims recently considered this problem, and in a divided opin-

[12] *Cf. Scheuber* v. *Commissioner, supra.*

ion; permitted such evidence to be considered. *Tibbals v. United States*, 362 F.2d 266, 272, 280 (1966).

Petitioners submit that the sanctity of Federal income tax returns filed by third parties is an important factor in the administration of the Internal Revenue Code;[12] and that this clear conflict between the Circuit Courts should also be resolved by granting this petition for certiorari.

CONCLUSION

For the foregoing reasons this petition should be granted.

Respectfully submitted,

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[12] That third-party returns are protected from public disclosure appears to be required by: 18 U.S.C. § 1905; § 7213(a)(1) of the Internal Revenue Code of 1954; § 463 D. 7 of Treasury Decision 4945 (1939-2 Cum. Bull. 97); and Revenue Ruling 58-120 (1958-1 Cum. Bull. 498).

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 10,670.

JEROME S. MURRAY and GRACE H. MURRAY,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION TO REVIEW THE DECISION OF THE TAX COURT OF THE UNITED STATES.

(Argued December 9, 1966. Decided January 6, 1967.)

Before HAYNSWORTH, Chief Judge, and BRYAN and J. SPENCER BELL, Circuit Judges.

Stanley Worth (Scott P. Crampton, Joseph A. McMenamin and Korner, Doyle, Worth & Crampton on brief) for Petitioners, and Lawrence B. Silver, Attorney, Department of Justice, (Mitchell Rogovin, Assistant Attorney General, Meyer Rothwacks and Fred R. Becker, Attorneys, Department of Justice, on brief) for Respondent.

PER CURIAM:

This is a petition for review of a decision of the Tax Court finding that certain sales of real estate made by the husband were sales of capital assets, while other sales of real estate or of contractual interests in real estate, were of property held primarily for sale to customers in the ordinary course of Murray's business.

For the reasons stated by the Tax Court,[1] we deny the petition. Judge Kern's opinion is entirely consistent with the subsequent decision of the Supreme Court in Malat v. Riddell, 383 U.S. 569. Nothing in *Malat* requires a modification of the result in the Tax Court.

Affirmed.

[1] Jerome S. Murray and Grace H. Murray v. Commissioner of Internal Revenue, T.C. Memo. 1965-148.

APPENDIX B

[Filed January 6, 1967]

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 10,670.

JEROME S. MURRAY and GRACE H. MURRAY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION TO REVIEW THE DECISION OF THE TAX COURT OF THE UNITED STATES.

THIS CAUSE came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the said Tax Court of the United States, in this cause, be, and the same is hereby, affirmed.

CLEMENT F. HAYNSWORTH, JR.
Chief Judge, Fourth Circuit.

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 10,670.

JEROME S. MURRAY and GRACE H. MURRAY,
Taxpayers-Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION TO REVIEW THE DECISION OF THE TAX COURT OF THE UNITED STATES.

PETITION FOR REHEARING

Under the provisions of Rule 19 of the Rules of this Court, the taxpayer hereby petitions for a rehearing and reconsideration by this Court of its per curiam opinion entered herein on January 6, 1967, for the following reasons:

I. The Court Erred in Holding That the Tax Court's Opinion Is Entirely Consistent With the Decision of the Supreme Court in Malat v. Riddell

In connection with the holding that the opinion and decision of the Tax Court is consistent with *Malat* v. *Riddell,* 383 U.S. 569, 16 L.Ed. 2d 102 (1966), the Court's attention is respectfully directed to what the taxpayer conceives to be inconsistencies, resulting in conflict with the principles laid down in *Malat:*

1. To qualify as "profits and losses arising from the everyday operation of a business" under *Malat*, it must appear from the record facts that the taxpayer was selling real estate, or interests therein, to customers in the ordinary course of his business. As pointed out in taxpayer's briefs,[1] there are no evidentiary facts to support such a conclusion; instead, the facts found by the Tax Court support the opposite conclusion.[2] The Gordon contract for the purchase of some 500 acres of land was sold in 1955 to a purchaser who made an unsolicited offer to purchase the contract (App. 25-26). The taxpayer never acquired title to the land covered by the contract (App. 26), hence he had no opportunity to carry out his intentions of exploring the possibilities of engaging in timber, mining, or other operations relating to the land.[3]

2. The sale of the Gordon contract occurred in 1955. It was one of 5 sales in that year, all of which were treated by the Commissioner as capital gain transactions in the year 1955 (App. 13; Prin. Br. 9). The record does not show any sales by the taxpayer made in 1955 as a dealer in real estate. Nor is there any other evidence of record that any of the sales made in 1955 related to the everyday operation of a business by the taxpayer involving the sale of real estate to customers in the regular course of his business.

3. The "realization of appreciation in value" of the Gordon contract "accrued over a substantial period of time," hence it was properly determined by the Commissioner to result in a long-term capital gain in the year of sale (1955).

4. The limited number of sales by the taxpayer in 1955, all of which were determined to be capital gain trans-

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[1] Prin. Br. 9, 16; Rep. Br. 8-9.

[2] App. 9; Prin. Br. 15.

[3] The Tax Court's opinion stated (App. 52): "The only evidence of such intent and purpose was the unsupported self-serving testimony of Murray himself. It is not corroborated by the circumstances." But see Rep. Br. 12-13.

actions, established that the "primary" or "principal" business of the taxpayer in 1955 was that of an investor who was holding property for "the realization of appreciation in value accrued over a substantial period of time" under *Malat* (383 U.S. at 572).

II. The Per Curiam Opinion Conflicts With Arrowsmith v. Commissioner

Arrowsmith v. *Commissioner*, 344 U.S. 6, 97 L.Ed. 6 (1952), in clear terms, laid down the principle that in the case of a sale or exchange the character of the transaction is fixed at the time of the sale or exchange. In that case, in the year of the exchange (liquidation) the resulting gain was held to be a capital gain. Accordingly, all subsequent transactions relating to such exchange were capital gains or losses, as the case may be.

The principles laid down in *Arrowsmith* have not been qualified or amended by the Supreme Court and, accordingly, apply in the instant case. *Arrowsmith* has been followed consistently by various Courts of Appeals. *Campagna* v. *United States*, 2 Cir., 290 F.2d 682 (1961); *Wener* v. *Commissioner*, 9 Cir., 242 F.2d 938 (1957); *Commissioner* v. *Adam, Meldrum & Anderson Co.*, 2 Cir., 215 F.2d 163 (1954); *Duveen Bros., Inc.* v. *Commissioner*, 2 Cir., 197 F.2d 118 (1952); Mertens, *Law of Federal Income Taxation*, 1966 Revision, § 22.24, n. 6, 7, and § 22.97, n. 59.

Under the *Arrowsmith* principle the treatment by this taxpayer, and by the Commissioner, of the sale of the Gordon contract in 1955 as a long-term capital gain transaction, fixed the character of the transaction. Subsequent collections by the taxpayer in the years here involved, under the installment method of reporting, necessarily required the same treatment, as capital gain transactions, that was given the sale in 1955, to comport with the *Arrowsmith* principle. Yet for the years here involved, the Tax Court disregarded the nature of the sale in 1955 as a capital gain transaction (so recognized and determined

by the Commissioner for that year), in holding that collections pursuant to that sale which were received by the taxpayer in later years constituted ordinary income. The Tax Court sustained the Commissioner in that respect.

Although *Arrowsmith* was fully briefed by the taxpayer in his principal brief and his reply brief, filed herein, the per curiam opinion gives no indication that the taxpayer's contention that *Arrowsmith* controlled in the instant case was even considered by the Court; or, if considered, it was distinguished on specific grounds, not stated in the opinion. In fact, the opinion is silent as to *Arrowsmith*.

Respectfully submitted,

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Certificate of Counsel

The undersigned, counsel for the taxpayers-petitioners in the above-entitled case, hereby certify that this petition for rehearing is signed in good faith, and not for delay.

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APPENDIX D

Internal Revenue Code of 1954:

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

• • • •

(26 U.S.C. 1958 ed., Sec. 1221.)

SEC. 1234. OPTIONS TO BUY OR SELL.

(a) TREATMENT OF GAIN OR LOSS.—Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, a privilege or option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the option or privilege relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him).

• • • •

(c) NON-APPLICATION OF SECTION.—This section shall not apply to—

(1) a privilege or option which constitutes property described in paragraph (1) of section 1221;

(2) in the case of gain attributable to the sale or exchange of a privilege or option, any income derived in connection with such privilege or option which, without regard to this section, is treated as other than gain from the sale or exchange of a capital asset;

(3) a loss attributable to failure to exercise an option described in section 1233(c); or

(4) gain attributable to the sale or exchange of a privilege or option acquired by the taxpayer before March 1, 1954, if in the hands of the taxpayer such privilege or option is a capital asset.

• • • •

(26 U.S.C. 1959 ed., Sec. 1234.)

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 126

JEROME S. MURRAY AND GRACE H. MURRAY,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The principal issue in this case is whether petitioner [1] held three tracts of real property "primarily" for investment purposes, thus qualifying them for treatment as capital assets, or whether he held them "primarily" for sale to customers in the ordinary course of his trade or business, with the result under

[1] "Petitioner" refers to Jerome S. Murray. His wife is a party solely because joint returns were filed for the years in question.

Section 1221(1) of 1954 Code that any profit on their sale should be treated as ordinary income. The Tax Court first determined that petitioner's business included dealing in real estate, although he also was an investor with respect to some properties (R. 23, 50.)[2] That court then found petitioner had held the three properties here involved primarily for sale to customers in the ordinary course of his business, and that the profits received during the years 1957 through 1961[3] in installment payments should be taxed as ordinary income. (R. 54, 56, 79.) The Fourth Circuit affirmed, finding the Tax Court's decision consistent with this Court's intervening opinion in *Malat* v. *Riddell*, 383 U.S. 569 (Pet. 1a-2a).

Each of the lower courts applied correct standards of law to findings of fact having ample support in the evidence, and there is no conflict with any other court of appeals decision rendered since *Malat*. Accordingly, no occasion for further review is presented.

1. Whether petitioner was a dealer in real estate is a fact to be determined from examination of all available facts concerning petitioner's business activi-

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[2] "R." references are to the Appendix to the taxpayer's brief in the court of appeals. "Supp. R." references are to Appendix B to the Commissioner's brief in the court of appeals.

[3] Petitioner has not sought appellate review with respect to 1957. Although the Tax Court found that three properties sold in that year had been held in petitioner's capacity as a dealer (R. 68-70), reversal would not have affected petitioner's tax liability for that year, as he had an overall loss that by reason of Section 172(d)(2)(B) of the Code could not be applied to reduce income in other years.

ties. *Gault* v. *Commissioner*, 332 F. 2d 94 (C.A. 2). That his usual and predominant source of income consisted of profits from the sale of real estate (R. 49-50) may in itself be sufficient to support the Tax Court's finding.[4] See *Frankenstein* v. *Commissioner*, 272 F. 2d 135 (C.A. 7). The Tax Court in addition found support for its conclusion in the number, continuing nature, and substantiality of petitioner's real estate transactions, and in the fact that petitioner at times found it necessary to transact his business through a straw man, because knowledge of his interest would cause increased market prices (R. 22, 49-50; Supp. R. 34-35). In these circumstances, the Tax Court's conclusion is in accord with those reached by various courts of appeals in comparable situations. *E.g.*, *Gault* v. *Commissioner*, *supra*; *Frankenstein* v. *Commissioner*, *supra*; *Mauldin* v. *Commissioner*, 195 F. 2d 714 (C.A. 10).

Petitioner does not dispute the underlying facts taken into consideration below, but disagrees with the relative importance attached to them (see Pet. 10-11). Whether he acted as a broker—*i.e.*, on behalf of others—is not pertinent; the question is whether he bought and sold on his own behalf. That he did not advertise is hardly conclusive where petitioner has ready access to the market so that advertising is not needed to bring customers in. *Gault* v. *Commissioner*, *supra*; *Mauldin* v. *Commissioner*, *supra*. Nor was

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[4] In no event could the sizeable amount of those profits show, as petitioner seems to assert (Pet. 11), that he was not a dealer.

there error in the Tax Court's reliance on the absence of rental or other investment income on certain properties; petitioner did not claim an intent to hold property for long term appreciation, and the Tax Court refused to credit his testimony about his unrealized but intended means of securing investment income.[5] (See R. 52-53.)

2. The Tax Court recognized that the purpose of holding a specific parcel of real estate is to be determined from examination of a variety of circumstances, and that each case "turns upon its own peculiar facts" (R. 48). Accord: *Scheuber* v. *Commissioner*, 371 F. 2d 996, 998 (C.A. 7); *Mauldin* v. *Commissioner*, *supra*. It thus reviewed all the circumstances attendant upon a number of petitioner's transactions. Although its opinion was written prior to this Court's decision in *Malat*, the Tax Court tested its conclusion with respect to each transaction by the interpretation of the word "primarily" in Section 1221(1) of the Code—a meaning of "first importance" or "principally"—developed by the Eighth Circuit in *Municipal Bond Corp.* v. *Commissioner*, 341 F. 2d 683, and approved by this Court in *Malat*, 383 U.S. at 572 (R. 50, n. 6).

The holding of some of the parcels at issue below was found to have been for investment and not primarily for sale to customers in the ordinary course

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[5] Neither *Malat* v. *Riddell*, nor *Scheuber* v. *Commissioner*, 371 F. 2d 996 (C.A. 7), is pertinent in determining the nature of petitioner's business, since in each case the taxpayer conceded that he was a real estate dealer at least with respect to some properties.

of business.[6] The Tax Court found, on the other hand, that three parcels, the Gordon Tract, the Berry Option, and the Adams or "Potomac" property, had been held primarily for sale in the regular course of business, and therefore did not qualify for treatment as capital assets (R. 54, 56, 70). In this Court, petitioner expressly attacks only the finding made with respect to the Gordon Tract (Pet. 7).

In December 1952 petitioner contracted to purchase for $1,000,000 approximately 500 acres owned by the Estate of Fulton R. Gordon. Because of delays in securing a survey and clearing title, the purchase had not been closed by the middle of 1954. At that time, petitioner was approached by a broker representing a prospective purchaser of the property. After ensuing negotiations, petitioner in March 1955 assigned his rights to the property in a transaction[7] that resulted in the deficiency challenged below. (R. 23-26.)

No evidence was introduced to demonstrate, and no claim has been made, even in this Court, that petitioner intended to hold the property for long term appreciation. The Tax Court refused to credit petitioner's "self-serving testimony" that he intended to use the land for the purpose of mining it for sand and gravel, selling the timber on it, and ultimately obtaining ground rents. The court noted that ground

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[6] Respondent did not seek review of the determinations favorable to petitioner.

[7] The transfer included other rights that petitioner secured in the process of clearing title, and contiguous tracts acquired during 1953 and 1954. (R. 25-26.)

rents are in any event frequently created in Maryland for the purpose of capitalizing profits upon the subdivision and resale of lots in a real estate development (R. 52-53). See, *e.g.*, *Welsh Homes, Inc.* v. *Commissioner*, 279 F. 2d 391, 394 (C.A. 4). Because of the timing and circumstances of the sale, and in view of the lack of any attempt to secure investment income from the property, the court concluded that the rights to the Gordon property had been held primarily for sale in the ordinary course of business (R. 53-54).[*]

Petitioner's reliance on an asserted conflict with *Scheuber* v. *Commissioner*, *supra*, is misplaced. In *Scheuber*, the Seventh Circuit overturned as clearly erroneous a Tax Court finding that the taxpayer had held two tracts of real estate primarily for sale in the ordinary course of business. On that record, an important consideration, on which petitioner places particular reliance here (Pet. 7), was the amount of profit. 371 F. 2d at 999. One of Scheuber's parcels had appreciated from $12,000 to $32,000; the other from $10,000 to $30,000 for one half and $100,000 for the other half. The holding periods of 5 to 14 years were apparently inconsistent with Scheuber's practice of selling within "a short time" prop-

[*] Petitioner made no claim that he had held for appreciation either the Berry Option, which was owned for 9 months, or the Potomac property, which was sold after 3 years. The Tax Court found "unconvincing" petitioner's claim that an investment use of the Berry property existed in his asserted intention to create ground rents (R. 38, 55-56). The Tax Court could find no evidence indicating an investment purpose for holding the Potomac property (R. 70).

erties held as a dealer. See *id.* at 997. In the present case the facts are materially different. The Gordon contract was sold at a profit of $1,890,000 on the basis of a purchase price in excess of $1,000,000, little more than 2 years after the first, and less than a year after the last, rights to the property were acquired (R. 13, 25).

3. There is no merit to petitioner's position that the Commissioner was foreclosed from asserting deficiencies with respect to installment payments received in later years (R. 27, 38) because petitioner's treatment of the transactions as capital was not disputed in audits of petitioner's returns for 1955 and 1956, the years, respectively, of the Gordon and Berry sales. Audit without taking exception to a taxpayer's treatment of income from a transaction in one year does not estop the Commissioner from challenging the tax treatment of income from the same or a similar transaction in other years, see, *e.g.*, *Niles Bement Pond Co.* v. *United States*, 281 U.S. 357, 361-362; *Municipal Bond Corp.* v. *Commissioner*, 341 F. 2d 683, 691 (C.A. 8) (installment payments upon the sale of real estate); *Mt. Vernon Trust Co.* v. *Commissioner*, 75 F. 2d 938, 940 (C.A. 2), or shift to the Commissioner the burden of proof with respect to the other years, see *Walker* v. *Commissioner*, 362 F. 2d 140, 142-143 (C.A. 7); *Easter* v. *Commissioner*, 338 F. 2d 968, 969-970 (C.A. 4), certiorari denied, 381 U.S. 912.

There is nothing to the contrary in *Arrowsmith* v. *Commissioner*, 344 U.S. 6. In that case, the taxpay-

ers had received liquidation distributions from a corporation in 1937 through 1940, which were concededly capital income. But in 1944 they were required, as transferees of the corporate assets, to pay a judgment against the corporation. This Court held that it was proper, in determining whether the 1944 repayment was a capital or ordinary loss, to take into consideration all of the pertinent events beginning in 1937, and that such an approach was not an attempt to reopen the tax returns for the earlier years.

In the present case the Commissioner did precisely what this Court approved in *Arrowsmith*. He did not attempt to reopen the returns for 1955 and 1956, for which the limitations period had run, but examined the events of those earlier years in determining the character of resulting payments received in the later years.

4. Nor was there error in the Tax Court's consideration of the activities and tax returns of petitioner's wholly owned corporation, Stewart's Corner. The disclosure of the corporate tax returns was lawful since it occurred in a judicial proceeding. *Blair* v. *Oesterlein Co.*, 275 U.S. 220, 227. Moreover, petitioner had used the corporation as his agent and "straw" (R. 22, 35, 40), so that its activities were properly given probative force in determining the nature of petitioner's business. See *Municipal Bond Corp.* v. *Commissioner*, *supra*, at 691; *Kaltreider* v. *Commissioner*, 255 F. 2d 833, 838 (C.A. 3); *Bauschard* v. *Commissioner*, 279 F. 2d 115, 116 (C.A. 6).

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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SUPREME COURT, U. S.

SEP 22 1967

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

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v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITIONERS' REPLY TO MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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In the petition for certiorari, *Scheuber* v. *Commissioner,* 7 Cir., 371 F. 2d 996 (1967), was cited as being in conflict with the decision of the Fourth Circuit in the instant case. In fact, in theAmerican Bar Association Journal, September 1967, the *Scheuber* case is referred to as the first Court of Appeals case to apply the principles laid down in *Malat* v. *Riddell,* 383 U. S. 569.[1] Since the *Scheuber* decision, two other Circuit

[1] *Tax Notes,* 53 A.B.A.J. 863.

Courts have recently spoken on the application of the *Malat* principles, namely, *Joan E. Heller Trust, et al.* v. *Commissioner,* 9 Cir. (8/24/67), —— F. 2d ——, 67-2 USTC ¶ 9626, and the *Municipal Bond Corporation* v. *Commissioner,* 8 Cir. (9/1/67), —— F. 2d ——, 67-2 USTC ¶ 9633. These two recent decisions reflect a unanimity of views between the Seventh, Eighth and Ninth Circuits since they are clearly in agreement with *Scheuber*. Thus, the decision below stands alone in sanctioning principles which conflict with those enunciated in *Malat* v. *Riddell, supra.*

The respondent states that the Fourth Circuit affirmed the Tax Court's decision, finding it "consistent with this Court's intervening opinion in *Malat* v. *Riddell,*" (p. 2). The petitioner and the Court would be much more enlightened as to the Fourth Circuit's views of the *Malat* principles as they applied to the instant case had an explanatory opinion accompanied its decision. Likewise, such an opinion of the Court below would have left no doubt as to its views with respect to application of *Arrowsmith* v. *Commissioner,* 344 U.S. 6, with respect to fixing the character of the transaction in the year of sale.

Since the Seventh, Eighth and Ninth Circuits have found it necessary to reverse the Tax Court by reason of the principles laid down in *Malat* v. *Riddell,*[2] the older cases which predated *Malat* v. *Riddell,* cited in respondent's brief in opposition, are of doubtful value.

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[2] In the *Municipal Bond Corporation* case, *supra,* it is the second reversal, the first being reported at 341 F. 2d 683, cited in the petition herein (pp. 10, 13) and in the opposing memorandum (p. 7). It is significant that the Tax Court opinion following the first remand was entered after the *Malat* decision, and the second reversal by the Eighth Circuit was for failure to apply the *Malat* principles.

With particular reference to the Gordon Contract, the respondent refers to the absence of rental or other investment income (p. 4) and to petitioner's "self-serving testimony" (p. 5) as to his intended use of the property. He also refers to the lack of any attempt to secure investment income from the property (p. 6) as another reason for the Tax Court's holding "that the rights to the Gordon property had been held primarily for sale in the ordinary course of business (R. 53-54)" (p. 6). Bearing in mind that it was the contract which the petitioner sold, not the land covered by the contract of sale, it is difficult to understand how, under the circumstances, he could possibly have carried out any intentions he had as to the use of the land. He sold the contract without ever acquiring title to the land. For the same reason, the petitioner was never in any position to obtain "investment income" from the property.[3]

In both *Joan E. Heller Trust, supra,* and *Municipal Bond Corporation, supra,* the respective Circuit Courts noted error in that the conclusion of the Tax Court was not supported by the facts. The instant petition, as the fourth reason for granting certiorari (p. 10), alleges a similar error, which also was raised below in the Petition for Rehearing (App. C, Point I, ¶1), which was summarily denied.

In its memorandum in opposition, the Government speaks of the "number" of sales made by the taxpayer (p. 3).

During the years 1950 through 1963 considered by the Tax Court, the taxpayer made a total of 26 sales.

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[3] *Malat* v. *Riddell* imposes no requirement that real property held for investment must be income-producing.

Excluding the three sales under threat of condemnation (R. 42-43, 62-68) and the sale at cost to Georgetown University (R. 39-42, 60-62), the taxpayer made 22 sales during a period of 14 years, or an average of a little better than one and a half sales a year, and these properties had been held—on an average—about ten years.

All but four of these sales were held by the Commissioner of Internal Revenue or by the Tax Court to result in capital gains. These *four* are the "numerous sales" relied on by the Tax Court in finding the taxpayer to be in a business (R. 49-50).

Four sales in 14 years can scarcely result in the "busyness"[4] needed for a dealership status or in the "everyday operation of a business."[5]

The respondent gives short shrift to petitioner's third reason for granting the writ (p. 8), namely, failure to give effect to *Arrowsmith* v. *Commissioner,* 344 U.S. 6 (1952). He would have it appear that the Commissioner passively failed to challenge the treatment of the Gordon Contract sale as a capital transaction in the year of sale (1955), hence his inaction did not evidence his agreement that it was the sale of a capital asset (p. 7). However, the Commissioner took affirmative action for the year of sale. Not only did he recompute the long-term capital gain from $1,890,000, as reported, to $1,875,062.06, as corrected; but by reason thereof, he determined an overpayment and made a refund for 1955, as found by the Tax Court (R. 23). See also Ex. 8-H, p. 11. Cf. R. 73-74.

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[4] *Ross* v. *Commissioner,* 5 Cir., 227 F. 2d 265, 269.

[5] *Malat* v. *Riddell,* 383 U.S. 569, 572.

Just as in *Arrowsmith* the liquidation fixed the character of the transaction as a long-term capital gain, so too did the sale of the Gordon Contract in 1955, and the capital gain treatment accorded by the Commissioner for that year, fix the nature of the transaction. And, under *Arrowsmith,* once the character of the transaction has been determined, all subsequent transactions with respect thereto are of the same character..

Respondent's Memorandum in Opposition contains the following paragraph (p. 8):

> In the present case the Commissioner did precisely what this Court approved in *Arrowsmith.* He did not attempt to reopen the returns for 1955 and 1956, for which the limitations period had run, but examined the events of those earlier years in determining the character of resulting payments received in the later years.

Contrary to the above statement, the Commissioner in the instant case did precisely what this Court held could not be done in *Arrowsmith.* In *Arrowsmith* the taxpayer urged upon this Court that notwithstanding the original transaction involving liquidation of a corporation and treatment of the resulting gain as gain from the sale or exchange of a capital asset, a later judgment against the liquidated corporation which the taxpayer, as transferee, was required to assume should be treated as an ordinary loss rather than a capital loss. This Court held that the character of the transaction was fixed at the time of the liquidation of the corporation as gain on a sale or exchange of a capital asset; that any subsequent transaction which related to the liquidated corporation, whether income or deduction, had the same character as that originally

determined; and hence the loss in question was a capital loss and not an ordinary loss.

Factually, the instant case is stronger than was *Arrowsmith*. The reasons for the dissents in *Arrowsmith* do not exist here since at the time of the installment sale (1955 in the case of the Gordon Contract), there was no uncertainty as to the installment payments which were to be made in subsequent years. On the contrary, in *Arrowsmith* at the time of complete liquidation and distribution of the corporate assets, subject to its liabilities, there was no means of knowing what, if any, additional assets or additional liabilities might thereafter come to light, and if so, when. If the decision below stands, we will have the anomalous situation where the sale in 1955 was a capital gain transaction but installment collections on that sale, received in the years before the Court, represented ordinary income. In light of the popularity and volume of installment sales, it should not be required of a selling taxpayer that he qualify the sale as a capital gain transaction, not only in the year of sale, but as to each subsequent installment collection in each succeeding year.

Arrowsmith v. *Commissioner*, 344 U.S. 6, was decided in 1952. A petition for rehearing was denied, 344 U.S. 900. Since that time this Court has never found any occasion to overrule or even modify the decision. If the decision below is allowed to stand, *Arrowsmith* will in effect have been nullified by the Tax Court, with the approval of the Fourth Circuit, by completely disregarding the principle that the nature of the sale of the Gordon Contract in 1955 was fixed as the sale of a capital asset. It was so reported by the taxpayer; and it was so accepted by the Com-

missioner—in fact he recomputed the amount of capital gain in a reduced amount, and made a refund of tax for that year.

On the principle laid down in *Arrowsmith,* without more, the decision of the Tax Court, as approved by the Circuit Court, clearly should be reversed.

For that reason alone it is urged that the Petition for a Writ of Certiorari should be granted.

As an additional reason for granting the writ, in light of the decisions by the Seventh, Eighth and Ninth Circuits which uniformly applied the principles of *Malat* v. *Riddell,* and the conflict between those decisions and that of the Fourth Circuit in the case at bar, justice will best be served and further litigation avoided by granting this petition.

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